The Strong Dollar: Currency and International Trade

Expansion of international markets and export development are at the core of Idaho's promotional strategy.

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The U.S. is one of the most open economies in the world as imports and exports of goods and services flow consistently.

U.S. History Which Created Today's Monetary and Fiscal Policy

The Employment Act of 1946 *directed* policymakers to pursue policies to achieve full employment and noninflationary growth and the Humphrey-Hawkins Full Employment & Balanced Growth Act of 1978 *required* these policies. The natural rate of unemployment is targeted at 4.5%. A moderate and bearable rate of inflation is considered to be between 1-2% (although 0% is preferred).

The Federal Reserve (Fed) uses different tools to work towards full employment, stable prices, satisfactory balance of payments and sustainable economic growth. These policies contribute to a strong, stable dollar.

The Federal Reserve

The foreign-exchange value of the dollar has an effect not only on the prices one pays but also on the prices in the entire U.S. economy. Depending on the strength or weakness of the dollar with respect to other currencies, the impact on individuals and businesses will vary. When the dollar is strong, the cost of buying goods and services from abroad is lower than when the dollar is weak. On the same note, U.S. exports are more costly for foreign buyers.

Value of dollar	Impact on imports/exports	Impact on inflation/output
Falls	Cost of imports rise	Increases U.S. inflation
	Cost of exports fall	Boosts U.S. output
Rises	Cost of imports fall	Decreases U.S. inflation
	Cost of exports rises	Reduces U.S. output

The Federal Reserve (Fed) influences international monetary policy and foreign exchange.

- Fed raises interest rates ➔ Foreigners want to invest funds in U.S. ➔ They convert their currencies into dollars ➔ Demand for dollars rise ➔ Value of the dollar rises
- Fed *buys* dollars for yen ➔ *Raises* the value of dollar, lowers the value of yen
  Fed *sells* dollars for yen ➔ *Lowers* the value of dollar, raises the value of yen

Strong versus Weak Currency

A currency is stronger than another currency when it can buy more foreign currency… for example, US$1 = 10.2 Mexican pesos (MP1=US$.09). A currency is weaker than another currency when it buys less of the foreign currency … for example, US$1 = .59 British pounds (£B1= US$1.70).

November 2003 Exchange Rates for US$1 (2002 exchange)

2.88 (3.74) Argentina Pesos	.841(.998) Euros	11.2 (10.2) Mexican Pesos
1.38 (1.78) Australian $	.59 (.63) British Pounds	29.8 (31.7) Russian Rubles
1.3 (1.58) Canadian $	7.76 (7.78) Hong Kong $	1.72 (1.78) Singapore $
630 (750) Chilean Pesos	109 (122) Japanese Yen	33.9 (34.9) Taiwan $
8.27 (8.27) Chinese Renminbi	1192 (1227) S Korean Won	

Exchange Service: http//fx.sauder.ubc.ca/

Let's look at an example of how currency exchange affects cost of production.
Labor: In 1985, the French Franc was worth close to 10F per US$1. If a line worker was paid 100 Francs per day, that was equivalent to US$10 per day. In 1999, the French Franc was worth close to 4 Francs per US$1. If the producer was required to keep the wages steady (or increase them as most people expect), the cost of labor would be closer to US$25 per day. The cost of production increases and therefore, the producer must pass this increase in the cost of producing a product onto the consumers. The result, the good costs more to buy for the consumer.

Advantages and Disadvantages of a Strong Currency

When a currency appreciates (exchanges for more of another currency—strengthens) or depreciates (exchanges for less of another currency—weakens), certain parties are helped or harmed. As the U.S. currency is currently stronger (valued higher) than many foreign currencies, the chart below shows how it effects U.S. citizens and industry:

Advantages	**Disadvantages**
* Imports cost less	* U.S. exports cost more for foreigners
* Competition from imports keeps domestic prices down	* Domestic suppliers will have more price competition
* When traveling abroad, the U.S. dollars exchanges for more foreign currency	* Foreign travelers find the U.S. more expensive
* U.S. investors can buy more foreign assets	* Foreign investment in the U.S. is more costly

How does this effect the Idaho farmer? The "law of one price" for a similar good is that a competitive market will equalize the price from one country to another if the currencies are of equal value. The Economist publishes annually a "Big Mac Index", comparing the price across countries. For instance, the Chinese Renminbi is undervalued compared to the USD, demonstrated by a price of CHY2.10 to USD2.55 for a Big Mac. When the USD is strong, it is more difficult for foreigners to buy U.S. products because they cost more relative to the products produced in their country (or another country with similar or weaker exchange rates). At the same time, some other countries can produce products cheaper than in the U.S in addition to having a devalued currency advantage. For example, the production cost of U.S. apples is similar to that of Chiles. In final pricing, Chilean apples will have more transportation costs. Nevertheless, U.S. and Chilean apples are priced the same in supermarkets due to Chile's undervalued currency.